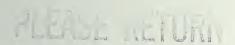
FINANCIAL STATEMENTS

Years Ended June 30, 1998 and 1997

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FINANCIAL STATEMENTS

Years Ended June 30, 1998 and 1997

Olness & Associates, P. C.

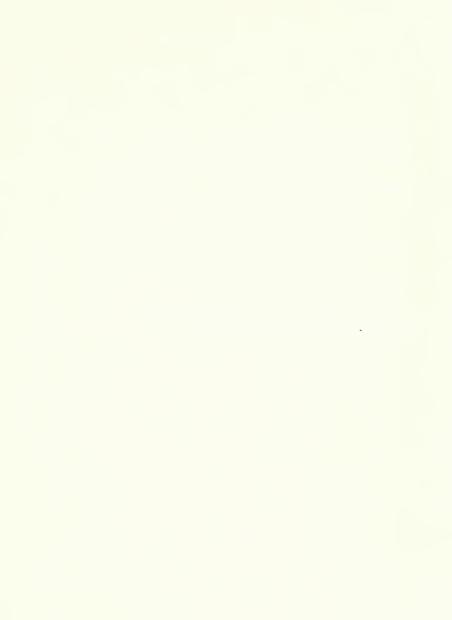
CERTIFIED PUBLIC ACCOUNTANTS

801 15TH STREET WEST PO BOX 23398 BILLINGS, MONTANA 59104-3398 (406) 252-6230 TOLL FREE (800) 814-9516 FAX (406) 245-6922



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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor John W. Northey, Legal Counsel Tori Hunthausen, IT & Operations Manager



Deputy Legislative Auditors: Jim Pellegrini, Performance Audit James Gillett, Financial-Compliance Audit

October 1998

The Legislative Audit Committee of the Montana State Legislature

Enclosed is the report on the audit of the Montana State Lottery for the year ended June 30, 1998.

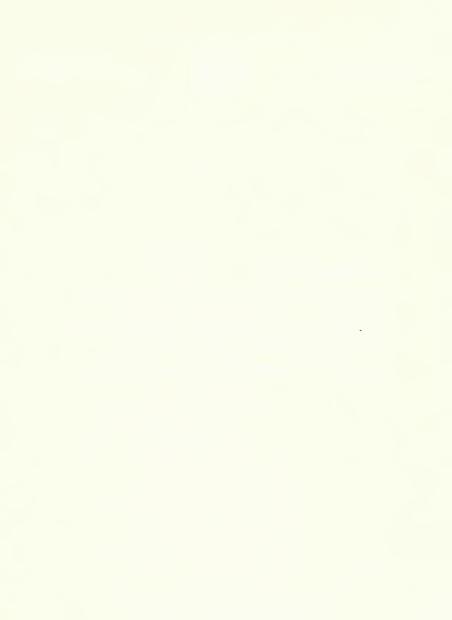
The audit was conducted by Olness and Associates, PC, under a contract between the firm and our office. The comments and recommendations contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

The report contains no recommendations. Therefore, the agency did not provide a response.

Sincerely,

Scott Seacat Legislative Auditor

98C-03



COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS

JUNE 30, 1998

COMMISSION MEMBERS RESIDENCE

Rebecca Erickson, Chairman Glasgow

Clifford Brophy Columbus

Donald Murray Kalispell

Carol Thomas Great Falls

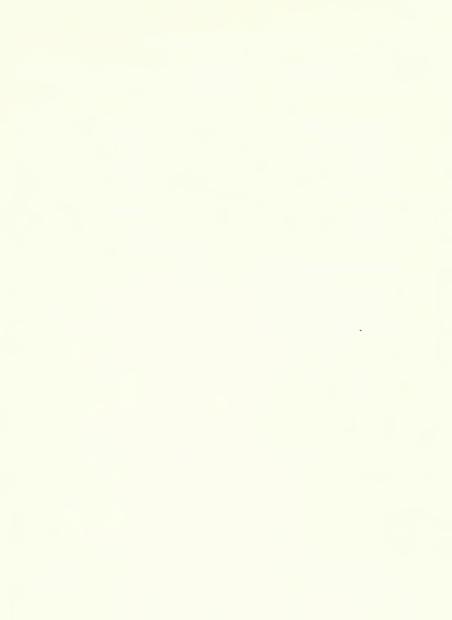
Robert Crippen Butte

ADMINISTRATIVE OFFICIALS

Jerry LaChere, Montana State Lottery Director

L. John Onstad, Director of Security

Leslie J. Darfler, Director of Operations



INTRODUCTION AND BACKGROUND

JUNE 30, 1998

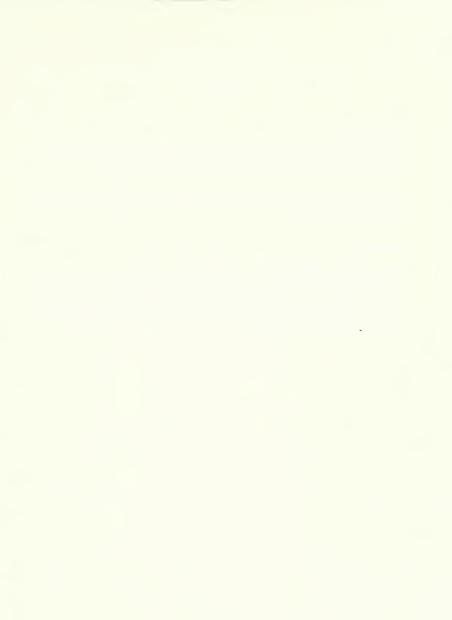
INTRODUCTION

The purpose of our contract with the State and Montana State Lottery was to conduct a financial-compliance audit of the Montana State Lottery's financial statements and issue an opinion on such. The scope of our services is defined in our contract with the Office of the Legislative Auditor, dated June 27, 1994, and as supplemented by certain requirements included in the bidder information.

As a result of our audit, we have also issued a report on compliance and on the internal control structure over financial reporting based on our audit of the financial statements performed in accordance with *Government Auditing Standards*.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund.



OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

ERNEST J. OLNESS, CPA

801 15TH STREET WEST PO BOX 23398 BILLINGS, MONTANA 59104-3398 (406) 252-6230 TOLL FREE (800) 814-9516 FAX (406) 245-6922

INDEPENDENT AUDITOR'S REPORT

To the Commissioners Montana State Lottery Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 1998 and 1997, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

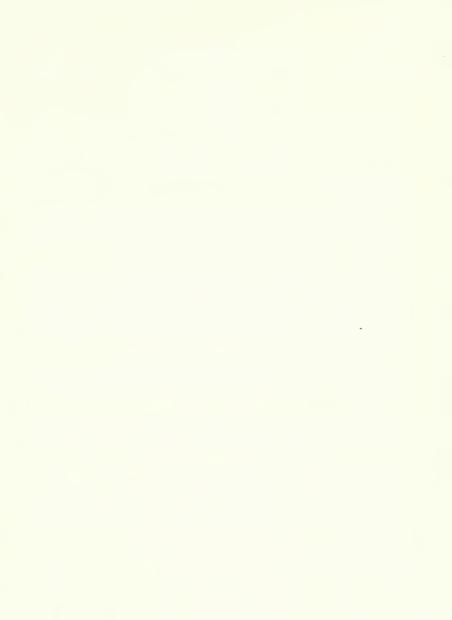
As discussed in Note 1, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 15 to the financial statements, the Lottery was required to change its fixed asset capitalization policy from \$1,000 to \$5,000 by the State of Montana.

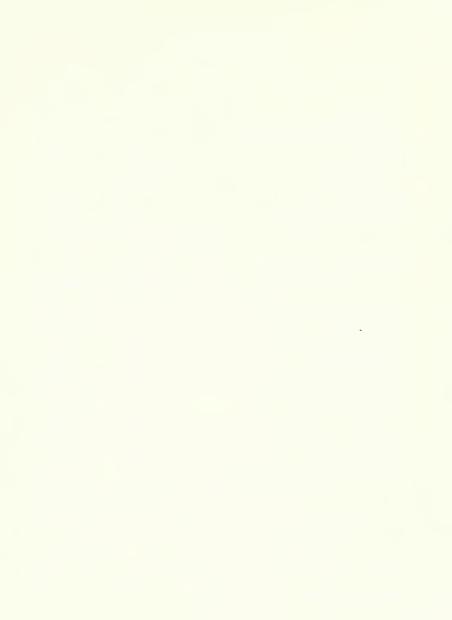
In accordance with Government Auditing Standards, we have also issued a report dated September 3, 1998 on our consideration of the State of Montana's internal control over financial reporting as it relates to the Montana State Lottery and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Olness + Associates, PC September 3, 1998



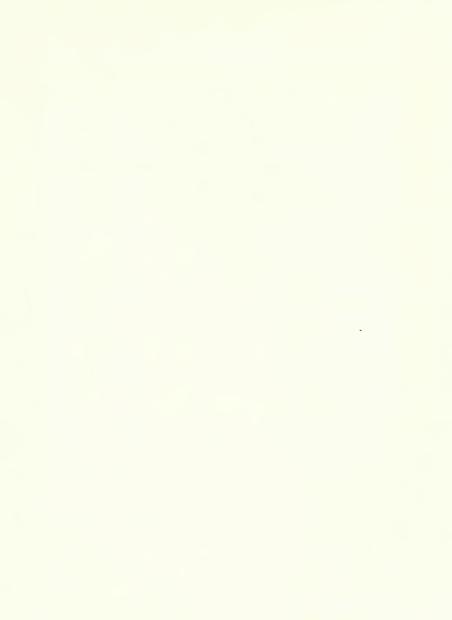
MONTANA STATE LOTTERY BALANCE SHEETS June 30, 1998 and 1997

	1998	1997
ASSETS		
CURRENT ASSETS Cash and cash equivalents (note 2) Accounts receivable, less allowance for doubtful	\$ 2,945,221	\$ 2,232,830
receivables of \$2,445 in 1998 and \$8,768 in 1997 Inventory	955,814 314,447	926,943 501,464
Other current assets (note 3)	266,888	81,072
TOTAL CURRENT ASSETS	4,482,370	3,742,309
FIXED ASSETS		
Furniture, fixtures and equipment	567,125	703,509
Accumulated depreciation and amortization	(395,821)	(425,707)
	171,304	277,802
OTHER ASSETS		
Long-term receivable (note 4)	1,880,647	1,846,016
	\$ 6,534,321	\$ 5,866,127
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 257,704	\$ 399,680
Estimated prize liability (note 5)	1,447,023	1,312,993
Transfer obligations (note 6)	2,259,184	1,741,375
Other current liabilities (note 7)	398,446	267,925
TOTAL CURRENT LIABILITIES	4,362,357	3,721,973
LONG-TERM LIABILITIES (note 8)	1,934,281	1,905,111
	6,296,638	5,627,084
FUND EQUITY		
Contributed capital (note 10)	237,683	239,043
COMMITMENTS AND CONTINGENCIES (notes 9 and 13)		
	\$ 6,534,321	\$ 5,866,127



STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS Years Ended June 30, 1998 and 1997

	1998	1997
OPERATING REVENUES		
Instant ticket games	\$ 7,747,761	\$ 6,063,023
On-line games	22,027,399	22,134,337
Miscellaneous	86,329	95,833
TOTAL OPERATING REVENUES	29,861,489	28,293,193
COST OF TICKET REVENUES		
Instant ticket prize expense	4,628,726	3,523,744
On-line ticket prize expense	10,610,680	10,808,835
Retailer commission	1,731,700	1,545,518
On-line vendor fees	2,769,047	2,594,942
Cost of tickets sold	627,641	415,472
TOTAL COST OF TICKET REVENUES	20,367,794	18,888,511
NET OPERATING REVENUES	9,493,695	9,404,682
OPERATING EXPENSES		
Advertising	640,454	688,342
Advertising production	131,433	188,343
Audit fees	35,354	54,740
Communications	137,796	145,497
Contractual services	166,715	139,143
Depreciation	58,939	96,633
Management fees	117,119	93,456
Multi-state operating fees	101,277	72,350
Other	45,248	65,012
Personal services	1,290,089	1,151,566
Repairs and maintenance	50,067	44,239
Supplies and materials	161,110	148,911
Utilities and rent	95,186	94,238
Travel	25,795_	24,613
TOTAL OPERATING EXPENSES	3,056,582	3,007,083
OPERATING INCOME	6,437,113	6,397,599



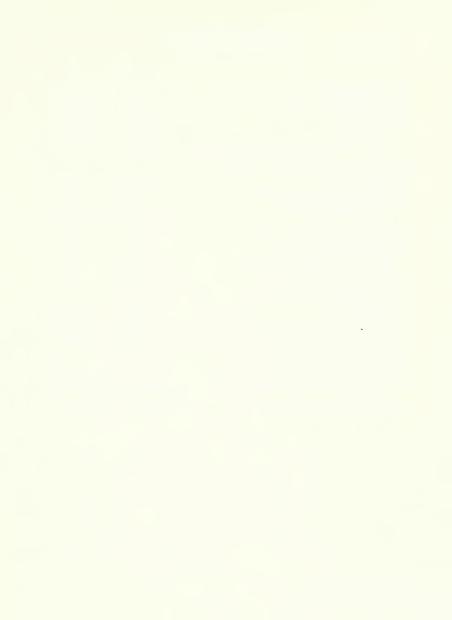
MONTANA STATE LOTTERY STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS Years Ended June 30, 1998 and 1997

	1998	1997
NONOPERATING REVENUES (EXPENSES)		
Interest income	250,986	211,662
Security lending income	6,125	7,573
Security lending costs	(5,975)	(7,165)
Loss on disposal of fixed assets		(6,409)
TOTAL NONOPERATING REVENUES (EXPENSES)	251,136	205,661
INCOME BEFORE OPERATING TRANSFERS	6,688,249	6,603,260
OPERATING TRANSFERS OUT		
General Fund	6,569,565	6,603,260
Study of the Socioeconomic Impacts of Gambling Fund	52,708	
TOTAL OPERATING TRANSFERS OUT	6,622,273	6,603,260
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	65,976	-
CUMULATIVE EFFECT ON PRIOR YEARS OF ACCOUNTING CHANGE	(65,976)	
NET INCOME (LOSS)	-	-
RETAINED EARNINGS, BEGINNING OF YEAR		
RETAINED EARNINGS, END OF YEAR	\$ -	\$ -



MONTANA STATE LOTTERY STATEMENTS OF CASH FLOWS Years Ended June 30, 1998 and 1997

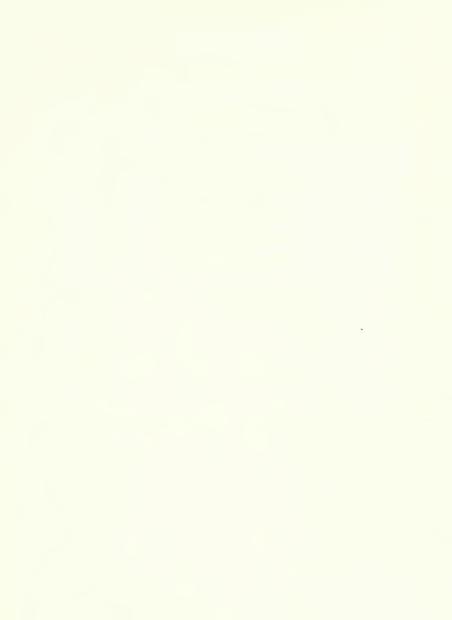
		1998		1997
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from sales	\$	29,842,806	\$	27,959,571
Cash paid to suppliers for goods and services		(6,835,260)		(6,592,907)
Cash paid to employees		(1,316,287)		(1,150,158)
Cash paid for prizes		(15,088,900)	_	(14,141,738)
NET CASH PROVIDED BY OPERATING ACTIVITIES		6,602,359	_	6,074,768
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES Operating transfers out:				
General Fund		(6,051,756)		(6,507,016)
Study of the Socioeconomic Impacts of Gambling Fund		(52,708)		
NET CASH USED BY NONCAPITAL				
FINANCING ACTIVITIES	_	(6,104,464)	_	(6,507,016)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Purchase of fixed assets		(36,640)		(29,215)
NET CASH USED BY CAPITAL AND RELATED				
FINANCING ACTIVITIES	_	(36,640)	_	(29,215)
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest received on investments		250,986		211,663
Security lending income		6,125		7,573
Security lending costs	_	(5,975)		(7,165)
NET CASH PROVIDED BY INVESTING ACTIVITIES	_	251,136	_	212,071
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		712,391		(249,392)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR		2,232,830		2,482,222
CASH AND CASH EQUIVALENTS, END OF YEAR	\$	2,945,221	\$	2,232,830



MONTANA STATE LOTTERY STATEMENTS OF CASH FLOWS Years Ended June 30, 1998 and 1997

Reconciliation of Operating Income to Net Cash Provided by Operating Activities

	1998		1998	
Operating income	\$	6,437,113	\$	6,397,599
Adjustment to reconcile operating income to net				
cash provided by operating activities				
Depreciation		58,939		96,633
Changes in assets and liabilities				
Increase in accounts receivable		(28,871)		(163,571)
(Increase)/decrease in inventory		187,017		(334,501)
(Increase)/decrease in other current assets		(185,815)		39,145
Increase in long-term receivable		(34,631)		(124,951)
Increase (decrease) in accounts payable		(125,113)		78,015
Increase in estimated prize liability		134,030		104,137
Increase/(decrease) in other current liabilities		130,520		(102,553)
Increase in long-term liabilities	_	29,170	_	84,815
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$	6,602,359	\$	6,074,768



NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commissions to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund. Section 23-7-401(5), MCA, states that for the purposes of funding a study of the socioeconomic impacts of gambling, \$100,000 of Lottery net revenue may be appropriated during the biennium ending June 30, 1999. \$52,708 of net revenue was utilized to fund the study during fiscal year 1998 and is reflected in the financial statements as an operating transfer out.

Reporting Entity

The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

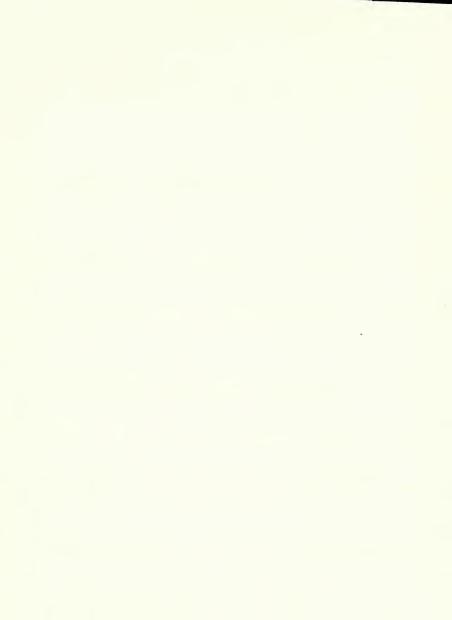
Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents

Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Inventory

Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated.



Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes

Prepaid prizes represent prizes purchased and on-hand in advance of game awards. Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Intangible Assets

Intangible assets represent the per ticket cost paid to Automated Wagering Inc. for advance on-line ticket sales. These ticket sales, also referred to as deferred revenue, represent tickets sold prior to June 30, 1998 and 1997 for drawings held subsequent to year-end.

Fixed Assets

Fixed assets are recorded at cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years.

Contributed Capital

Contributed capital represents equity acquired through contributions from vendors and the State of Montana

Compensated Absences

State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Reclassifications

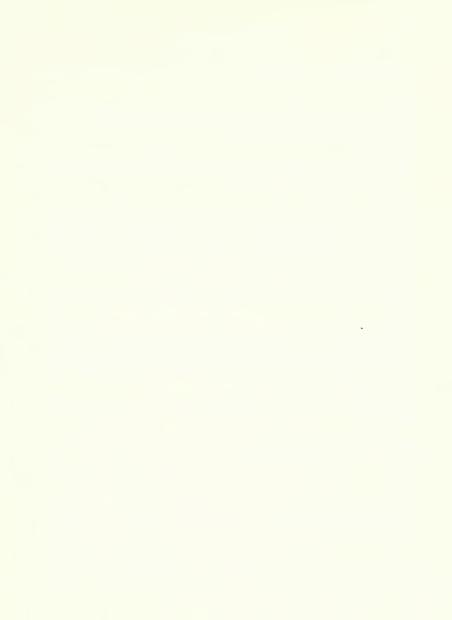
Certain reclassifications have been made to the 1997 financial statements in order to conform to the 1998 presentation.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	June 30,			
		1998	_	1997
Short-term investment pool	\$	2,901,850	\$	1,621,145
Cash on deposit with State Treasurer		33,221		601,535
Cash in revolving deposit account		10,000		10,000
Petty cash		150		150
	\$	2,945,221	\$	2,232,830

Reference to the audit of the State of Montana would identify GASB No. 28 disclosures and the level of



risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$15,663 and \$10,336 at June 30, 1998 and 1997, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE 3 - OTHER CURRENT ASSETS

Other current assets consist of the following:

	June 30,			
		1998		1997
Cash collateral - security lending transactions	\$	194,340	\$	43,646
Prepaid prizes and expenses		42,442		10,546
Intangible assets		13,246		9,665
Due from other state agencies		11,810		12,665
Employee advances	_	5,050		4,550
	\$	266,888	\$	81,072

NOTE 4 - MULTI-STATE LOTTERY ASSOCIATION

Joint Venture Association

In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto*America/Powerball game, Wild Card game and Cash 4 Life game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Pavable

As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

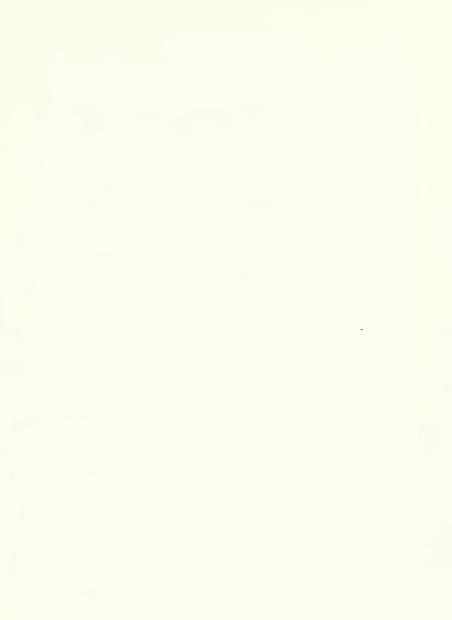
The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,880,647 and \$1,846,016 at June 30, 1998 and 1997, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$94,131,232 and \$92,733,659 for 1998 and 1997, respectively. The long-term liability balance of \$1,755,908 and \$1,739,432 at June 30, 1998 and 1997, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments

Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source



winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 1998 and 1997, MUSL held United States Government zero coupon bonds in trust for the Montana State Lottery winners with respective par values of \$75,997,948 and \$81,206,123 and respective market values of \$51,878,911 and \$50,924,260.

The Montana State Lottery has eight Lotto*America/Powerball/Tri-West winners. The combined total of future prize payments owed is \$75,997,000 and \$81,205,000 at June 30, 1998 and 1997, respectively. Total annual payments due over each of the next five years is \$5,208,000 annually and \$49,957,000 thereafter. The present value of future prize payments approximate the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

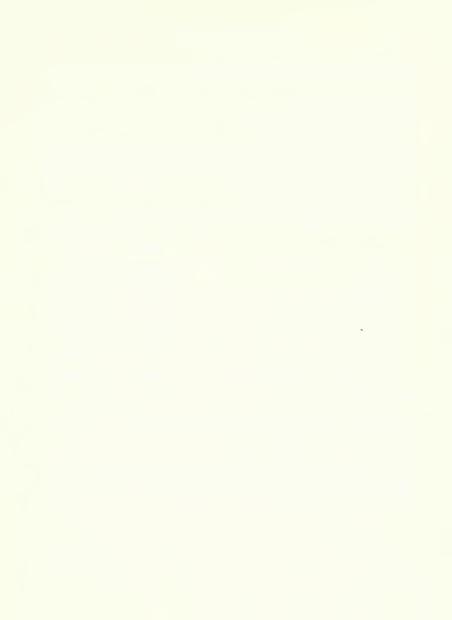
	June 30,			
	1998	1997		
Total assets	\$1,655,688,518	\$1,437,619,763		
Total liabilities	1,655,424,985	1,437,328,433		
Total net assets	263,533	291,330		
Total liabilities and net assets, unrestricted	\$1,655,688,518	\$1,437,619,763		
Total revenues	\$ 3,123,770	\$ 3,175,623		
Total expenses	3,151,567	3,100,012		
Increase (decrease) in unrestricted net assets	\$ (27,797)	\$ 75,611		

NOTE 5 - ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE 6 - OBLIGATION TO TRANSFER FUNDS

The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 1998 and 1997 were \$2,259,184 and \$1,741,375, respectively.



NOTE 7 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

Prize liability Multi-State Lottery Association

	June 30,		
	199	8	1997
Due to other state agencies		1,681 \$	120,350
Liability under security lending transactions	19	4,340	43,646
Deferred on-line revenue	14	2,425	103,929
	\$ 39	8,446 \$	267,925
NOTE 8 - LONG-TERM LIABILITIES			
Long-term liabilities consist of the following:			
		June 30,	
	199	8	1997

1,755,908

1,934,281

178,373

1,739,432

1,905,111

165,679

NOTE 9 - LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 2002. Rent expense under operating leases charged to operations was \$78,000 for the years ended June 30, 1998 and 1997.

NOTE 10 - CONTRIBUTED CAPITAL

Accrued compensated absences

Contributed capital decreased \$1,360 during 1998. The decrease is related to the State of Montana changing its fixed asset capitalization policy from \$1,000 to \$5,000.

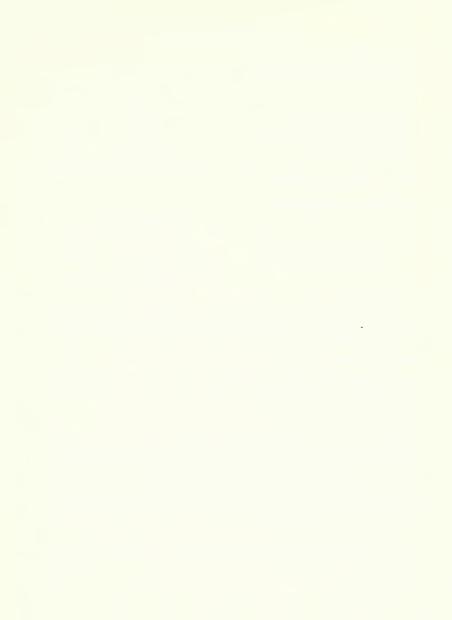
NOTE 11 - EMPLOYEE BENEFIT PLANS

Pension Plan

The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Public Employees Retirement Division, P.O. Box 200131, 1712 Ninth Avenue, Helena, MT 59620-0131, (406) 444-3154.

Contribution rates for the plan are required and determined by State law. The contribution rate for 1998, expressed as a percentage of covered payroll, was 6.7% for the employer. Effective July 1, 1997, the



contribution rate for 1998, expressed as a percentage of covered payroll, increased from 6.7% to 6.8% for employees.

The amounts contributed to the plan during the years ended June 30, 1998, 1997 and 1996, were \$130,220, \$115,558 and \$117,222, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan

The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts deferred under the plan created under Internal Revenue Code Section 457 remain the property of the State of Montana until paid, subject only to claims of the State of Montana's general creditors. Participants' rights under the plan are equal to those of general creditors of the State of Montana in an amount equal to the fair market value of the deferred account for each participant.

NOTE 12 - RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 1998 and 1997, total payments to other State agencies were approximately \$313,000 and \$319,000, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Instant Tickets

The Lottery has an agreement with BABN Technologies Corporation to print instant game tickets. The agreement expires June 30, 2001.

Maintenance Contract

The Lottery has an agreement with Stratus Computer, Inc. to provide for computer hardware and software maintenance. The agreement provides for quarterly payments of \$9,587. The agreement may be canceled by either party with proper notification.

On-line Vendor

Lottery is contracted with Automated Wagering to provide for the operation of an on-line gaming system through March 29, 1999.

Advertising

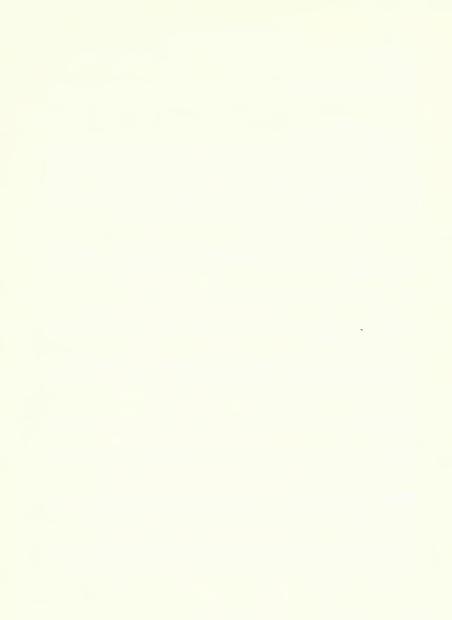
The Lottery signed a contract with Banik & Associates to provide advertising services for \$8,400 per month through December 1999.

Independent observation of drawings

Lottery is committed to Henry Fenton, CPA, to observe Montana Cash and other special drawings. The term of the contract is for one year ending June 30, 1999. Compensation will not exceed \$9,675.

Prize Contingencies

Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments



corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$2,234,559 and \$2,484,559 at June 30, 1998 and 1997, respectively, if the insurance carrier defaulted on their payments.

Litigation

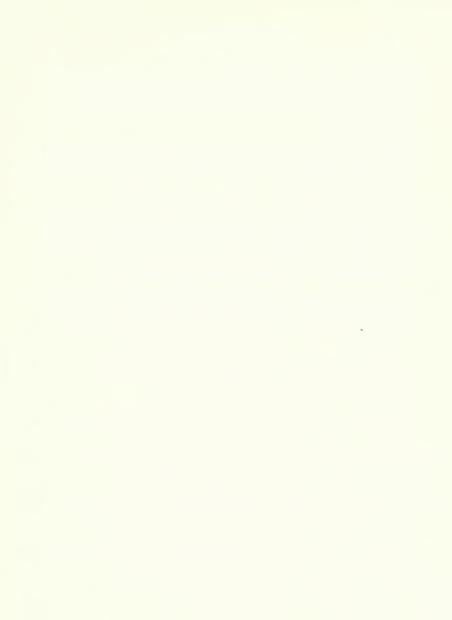
The Lottery is involved in two legal actions arising in the normal course of business. The Lottery intends to vigorously defend these actions. In the opinion of management and legal counsel, such matters will not have a material effect upon the financial position or results of operations of the Lottery.

NOTE 14 - SUBSEQUENT EVENT

On August 18, 1998, the Lottery signed a seven year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning no later than March 1999. The contract provides for payments to be made for the purchase of equipment as well as payments to be made based on a percentage of weekly Lottery sales. The estimated total contract price is approximately \$24 million over the seven years of the contract.

NOTE 15 - CUMULATIVE EFFECT ON PRIOR YEARS OF ACCOUNTING CHANGE

Effective July 1, 1997, the Lottery was required to change its fixed asset capitalization policy from \$1,000 to \$5,000 by the State of Montana. This change in accounting principle resulted in a charge to net income of \$65,976 for the year ended June 30, 1998.



OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners Montana State Lottery Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 1998, and have issued our report thereon dated September 3, 1998. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee. However, this report is a matter of public record and its distribution is not limited.

Olness / Associates, PC September 3, 1998

